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SUBJECT: ROMANIA'S PARLIAMENT PASSES 2005 BUDGET

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Summary

1. (U) In anticipation of the November 28 general elections, Romania's Parliament rushed to pass the budget this year, bypassing substantive debate. Both the 2005 state budget and social assistance budget laws, passed by both legislative chambers on November 10, and ratified by President Iliescu on November 22, changed little from the draft budget laws reviewed by the IMF and submitted to the Parliament in October. The budget anticipates a deficit of 1.5 percent of projected GDP. End Summary.

Parliament passed the 2005 budget with record speed

2. (SBU) In an unprecedented move, the Senate and Chamber of Deputies gathered in a joint session to debate the budget provisions expeditiously. Several members of Parliament were absent for the budget vote due to election campaign obligations. A few also used their absence as a protest against the superficial nature of the budget debates and the scant attention given to opposition proposals. The ruling Social Democratic (PSD) party expressed its satisfaction with the efficiency of the debates that lasted only two weeks, rather than the typical one to two months. The president ratified the legislative package on November 22, six days before the elections.

3. (SBU) Although the Parliament followed all constitutional steps in its debate and passage of the budget, many analysts felt that the process was on the edge of the law. Due to the incumbent party's desire to have the budget passed prior to elections, the debate and drafting was superficial and rushed.

Everyone gains in 2005

4. (SBU) The budget shows overall increases in every area, although certain ministries benefit to a greater extent than others. The Ministry of Education and research gains approximately 29 percent in the new budget, giving it the largest overall increase. The Ministry of Administration and Interior was granted the second largest gain, with 28 percent, followed by the National Defense Ministry, with 21 percent more funds next year. With military spending pegged to a strict 2.38 percent of GDP until 2008, this gain is primarily a result of projected GDP expansion. Although everyone wins to a certain extent in this optimistic budget, lower gains are slated for the Ministry of Justice, with only a 1.4 percent increase and the Ministry of Labor, Social Security and Family, with a 5.3 percent increase.

Note: Dollar amounts and percentages have been calculated using the average forex rate for 2004 compared with the current exchange rate. The Ministry of Finance's projected 2005 average exchange rate of ROL 35,150 for one USD now seems implausible due to current market conditions. The ROL has been on a solid appreciation trend since the central bank switched to a managed float policy at the end of October. Today the ROL trades at 28,780 to one USD, a difference of 22.1 percent with the Ministry of Finance's prediction for 2005.

Revenue Projections Overly Optimistic

5. (SBU) The Parliament based the 2005 state budget on the following leading indicators, which the IMF reviewed and sanctioned:

- Consolidated budget deficit of 1.5 percent of GDP, a decrease from 2004's 1.65 percent deficit target;
- Inflation rate of seven percent, in comparison with 2004's nine percent;
- Economic growth of 5.3 percent, much lower than the 8.1 percent annualized growth announced for the first nine

months of 2004; and
-Current account deficit not exceeding 5.4 percent of targeted GDP.

16. (U) Embassy notes that many analysts consider the 2004 growth rate to be at least somewhat exaggerated and unsustainable, as high agricultural gains due to favorable weather can be regarded as atypical for the climate patterns of recent years. The GOR is probably counting on revenue growth that will not materialize. The GOR may, therefore, need to increase import duties or issue additional Eurobonds, as well as raise taxes, to make up revenue shortfalls.

17. (U) As the basis for its tight budget policy, the ruling PSD party is counting on a projected 5.3 percent economic growth, a 10.3 percent increase in investments, lower tax evasion and higher excise taxes. Year 2005 revenues are projected at \$28.3 billion (31.2 percent of the GDP), while expenditures are programmed as US\$ 29.7 billion (32.7 percent of the GDP). These figures are based on a 2005 GDP projected to reach US\$ 90.8 billion. The state budget will distribute funds amounting to 6.6 percent of GDP to counties and municipalities. This is an increase of approximately 12.4 percent over 2004.

Intra-Ministerial Budget Gymnastics

18. (SBU) Although the budget law itself is indistinct and thus does not specify individual projects or programs for which money will be used, it includes an annex describing specific projects. This annex presents a more detailed level of information, often listing the budget indicators used to arrive at allocation decisions. The budget law strictly disallows transfers of money between departments or projects; when needs arise for intra-ministerial money shifting, a bizarre mechanism is used for reallocation. Departments in need of cash declare an official emergency, and then team up with other departments who officially declare a surplus. Only after these official statements occur can money be shifted from one area to another. In practice, intra-department shifts due to emergency declarations occur frequently. However, inter-ministerial shifts are much more rare and are approved only under official ordinance, only three of which occurred so far this year.

Future Budget Changes Likely Ahead

19. (U) PSD MPs and Minister of Finance Mihai Tanasescu presented the 2005 budget as an instrument of social welfare. Social spending will reach approximately 30 percent of the total budget expenditures or 9.8 percent of GDP. Minimum wage is set to increase 11 percent from 2004, reaching the net equivalent of \$108 per month. State sector wages will increase 12 percent in comparison with 2004. The new law also stipulates that the GOR will adjust pensions for inflation on a monthly basis, and that high payroll taxes will decrease two percentage points from the current 49.5 percent in an almost invisible attempt to discourage tax evasion.

10. (U) Opposition MPs criticized the majority party's quick passage of the budget as a means to bolster its election campaign. National Liberal (PNL) MPs declared that the economy's growth is a charade, propped up by debt and foreign remittances. Democratic Party (PD) MPs stated that the 2005 budget laws passed by the PSD-dominated Parliament legalize the discretionary allocation of funds based on waste and populist measures. The political opposition vowed to enact revised budget laws if successful in winning the legislative elections.

Comment

11. (SBU) The budget reflects the GOR agreement to the tight 2005 deficit target proposed by the IMF. However, the estimated 5.3 percent economic growth is an optimistic target. In 2004, the unusually high economic growth rate was due primarily to a surge in agricultural output, a volatile sector susceptible to unpredictable weather patterns. The GOR's goal of decreasing inflation to seven percent will also be a challenge, given rising international energy prices and increasing wages. The change in the Romanian leu's (ROL) denomination in the third quarter of 2005 may also have an effect as the new "heavy" ROL prices (dropping 4 zeros from the currency) are rounded up. In any case, this is a temporary document, with a new parliament and executive expected to make substantial amendments once the pressure and attention of the election season have passed.

Crouch